Green Taxation: a contribution to sustainability

The European Semester and Green Tax Reforms (environmental taxation and the removal of environmental Harmful subsidies) - a Contribution to the wider fiscal consolidation process

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Overview

- Environmental taxation – EU perspective
- The 'European Semester' process
- Key recommendations on tax policy
- The link to 'fiscal consolidation'
- Some points on Portugal
- Commission's proposal on energy taxation
Environmental taxation – EU perspective

- **Environmental taxes have dual benefit:**
  - they are amongst the least distorting the economy
  - and can encourage more environmentally responsible behaviour ("Pigouvian" taxes)
  - Provide opportunity for "tax shift"

- "Green" energy taxation can also help to encourage new industries and drive **green innovation**.

  —> Commission "Green Growth Strategy"; "European Semester" etc.
  —> Analysis of environmental tax incentives/subsidies (harmful vs. friendly); MBI-Forum etc.
Environmental taxation – EU perspective

Some topical issues

• Impact of increasing energy prices on desired tax levels? Relevance of divergent energy price trends USA/Canada vs. EU etc.?

• Relation energy and environmental taxes / competitiveness? How to assess risk of 'carbon leakage'?

• How to organise the coordination process necessary to deal with competitiveness issues (e.g. on tax subsidies)?

• Role in fiscal consolidation?

• Is 'tax shift' really working, employment created? Yes, but ...
The 'European Semester'

- **Part of the reinforced framework of EU (macro-)economic governance**
  - Serves surveillance of economic and fiscal policies, structural reforms, macro-economic imbalances
  - Together with stability and growth pact etc.
- **Coordination of economic and fiscal policy planning**
  - 'Upstream' policy coordination via annual cycle
  - Country-specific recommendations as outcome
- **In parallel for some countries:**
  - Economic Adjustment Programme leading to Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) agreed between the EC, the ECB, the IMF and country concerned
The 'European Semester' process

The European Semester

Policy guidance to EU and euro area
- January: Annual Growth Survey and Alert Mechanism Report
- February: Debate and orientations
- March: Dialogue on European Council conclusions
- April: In-depth reviews (imbalance procedure)
- May: Dialogue on European Council conclusions
- June: Proposals for country-specific recommendations
- July: Adoption of recommendations

Country-specific surveillance
- Autumn: Monitoring and peer review at European level
- Autumn: Implementation at national level

European Commission
- Spring EU summit: overall guidance on EU priorities

Council of Ministers
- Dialogue on orientations
- Discussion in Council formations

European Parliament
- Endorsement of country-specific recommendations

European Council

Member States
- Submission of National Reform Programme (NRPs) & Stability and Convergence Programme (SCPs)
Key recommendations on tax policy
(AGS 2012)

- **Tax shift** towards more pro-growth forms of taxation
- **Base broadening** in general
- **Promoting** *environmentally-friendly taxation*
  - Green taxation
  - Revision of Energy Tax directive
- **Limiting debt-bias** in tax systems
- **Tackling fraud and evasion**
Key recommendations on tax policy
(AGS 2013)

- **Substantial reduction of tax burden on labour**
- **Broadening of tax bases rather than increasing tax rates/introducing new taxes ('smarter revenue-raising')**
- **Phasing-out of environmentally harmful subsidies / increase environmental taxation**
- **Improving tax collection & compliance via tackling fraud and evasion**
- **Reducing corporate tax bias towards debt-financing**
- **Reform of real estate and housing taxation**
The link to 'fiscal consolidation'

• "On the revenue side of government budgets, recent trends show that many Member States have increased personal income taxes and/or VAT rates. There is, however, still scope to shift the overall tax burden towards tax bases that are less detrimental to growth and job creation, and to make tax systems more efficient, competitive and fairer. Such a shift requires a package approach which ensures equitable redistribution and is adapted to the circumstances of individual Member States."

• "The tax burden on labour should be substantially reduced in countries where it is comparatively high and hampers job creation. To ensure that reforms are revenue neutral, taxes such as consumption tax, recurrent property tax and environmental taxes could be increased."
The link to 'fiscal consolidation' (Portugal)

- Fiscal consolidation reduces scope for environmental policy measures on the expenditure side = need to use taxes as instruments in environmental policy

- Need to avoid competitive distortions across Member States

- Link to on-going review of Energy Taxation Directive and Emission Trading system (e.g. advising against national carbon taxes)
Some points on Portugal

• **Significant positive tax changes following MoU 2011, 2012, 2013 (VAT, excises, real estate taxes, PIT, CIT, social security ...)**

• **Environmental taxation:**
  
  • indexation of excise duties to core inflation, removal of reduced VAT rate on electricity and natural gas, increases in excise duties on fuels, heating diesel, electricity consumption and higher taxation of company cars; reduction of environmentally-related tax expenditures, e.g. on circulation and registration taxes ...
Some points on Portugal

• *Indications about environmental issues on waste management and air quality – potential to use MBIs?*

• *Environmentally harmful subsidies (agriculture)?*

• *Reducing direct subsidies to renewables?*

• *Potential of pollution/resources taxes (where Portugal lags behind the EU-average of 0.1% of GDP revenues)?*
Essence of the existing Energy Tax Directive [2003/96/EC]

- **Energy products are only taxed when they are used as motor or heating fuel**
- **Energy tax applies to electricity**, although there are several exemptions Member States can introduce
- **Some sectors excluded**: Energy products used as raw materials, for the purposes of chemical reduction, in electrolytic and metallurgical and in mineralogical processes are out of the scope of the Directive
- The "levels of taxation" applied by the Member States may not be lower than the **minimum rates** set in the Directive (higher minima for transport than for heating fuels)
- **Possibility of tax exemption for biofuels**
- **Taxable base**: Mineral oil products = volume / Coal, gas, electricity = energy content
Essence of the existing Energy Tax Directive [2003/96/EC]

• NO signal to reflect CO₂ emissions of energy products
• NO signal to reflect the energy content of the product used
• NO incentive to develop markets for alternative energies
• NO European framework for CO2 taxation
• NO sufficient coverage of 50% of emissions outside ETS
• NO clear distinction with ETS: double burden or loopholes to evade responsibility for emissions
Commission's proposal – rationale and design

- Commission proposal for a revision of the Energy Taxation Directive – COM (2011) 169 of 13 April 2011 – at the time a key Commission initiative especially as regards green taxation

- The proposal makes the structure of taxation more supportive of the EU climate and energy policy objectives to reach by 2020:
  - 20% cut in CO₂ emissions,
  - 20% improvement in energy efficiency and
  - 20% share of renewables

- Reflects 2008 European Council
  - notably the objective to bring ETD more closely into line with the EU's Energy and Climate Change objectives
Commission's proposal – rationale and design

- Split energy taxation into **two elements**, basing minimum rates on objective criteria:
  - One element based on **CO₂ emissions**
  - Another element based on the **energy content** (net calorific value) of each energy product

- **No CO₂ tax on sustainable renewable energy sources** (e.g. sustainable biofuels) in order to promote their use

- **No CO₂ tax applicable for companies falling under EU ETS**, avoiding double regulation and additional tax burden

- Numerous further points of detail
Commission's proposal – effects

- **It will eliminate cases of double burden** by complementing the EU Emission Trading System and modernising the way energy is taxed by coherently introducing CO$_2$ emissions and energy content as measure of the taxable base. There will be no CO$_2$ tax applicable for companies falling under EU ETS.

- **The double tax base will remove arbitrary decisions on tax rates** and thus distortions resulting from taxation.

- **There will be no CO$_2$ tax on sustainable renewable energy sources** (e.g. sustainable biofuels) providing **incentives for the development of "green" industries.**

- **It will contribute to change overall EU demand structure** (exporter of petrol, importer of diesel) even when no decisive impact on 'dieselisation' of car fleet expected.
Commission's proposal – expected impacts (environment)

- **Depends on how MS will implement the new framework**

- **Impact on CO\textsubscript{2} emission** reduction can be considerable
  - Up to -2\% of total CO\textsubscript{2} emissions by 2020
    - = -4\% of emissions outside EU ETS
    - = -92 million tons of CO\textsubscript{2}

- **CO\textsubscript{2} is the only externality addressed by the proposal because:**
  - It is directly related to the fuel
  - It does not depend on the combustion technology
  - It is really cross-border in nature

- **But proposal will lead to general environmental improvements, in particular of air quality**
Commission's proposal – expected impacts (economy)

- Depends on how MS will implement the new framework

- Assuming additional revenue can be used to reduce charges on labour (revenue recycling)

- Impact on GDP: Up to 0.21% and 0.27% additional GDP growth in, respectively, 2020 and 2030

- Impact on employment: Up to 0.29% and 0.39% growth in employment by, respectively, 2020 and 2030 = 1 million additional jobs in 2030

- Provides on opportunity for MS to restructure tax systems in a more growth- and job-friendly manner
  - There is room for increase in energy taxation and, more generally, environmental taxation
  - Link to 'European Semester' and fiscal consolidation
Commission's proposal – state of play and next steps

• Tax proposals are subject to a special legislative procedure which requires unanimous approval in the Council of the EU and an opinion from the European Parliament.

• The proposal was intensely discussed under Hungarian, Polish, Danish, Cypriot Council Presidency (and ECOFIN regularly informed with orientation debate in June 2012 and progress report December 2012). Discussions continue under Irish Presidency.

• Prospect of major reform slim (CO₂ tax optional only?); persistent lack of agreement on important issues. Topical issues of negotiations include:
  • Level and structure of minimum rates
  • Link between ETD and ETS
  • Tax treatment of biofuels and bioliquids
  • Tax treatment of agriculture, commercial diesel etc.
  • Transitional periods
  • Optional tax exemptions
THANK YOU!

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Annex

Some graphs for illustration
Evolution of the environmental and energy tax revenues
1995-2010, EU-25, in % of Total Tax Revenue
Environmental tax revenues by Member State and type of tax
2010, % of GDP
The current Energy Tax Directive - illustrations

- Figure 1 and 2 show that petrol is currently subject to higher taxation than diesel both in terms of CO₂ emissions and energy content.

- Figure 2 shows that biofuels are currently subject to much higher taxation than fossil motor fuels (E85, in the example, is a substitute for petrol containing 85% ethanol and 15% petrol).
Figure 3 and 4 show that gas oil is subject to higher tax rates than other heating fuels (in particular natural gas and coal). Consequences:

- No consistent price signal to reduce CO₂ emissions or to save energy
- Promotes more polluting products (e.g. coal) over other heating fuels
- Distortions in the internal market due to lack of a level playing field for business consumers (can be better off compared to others depending on energy source used)