

"Go green, go social"
5 December 2013

04.12.13

SPEAKING NOTES

Panel 2:

"Designing environmental policies without undermining our current welfares system; is it possible?"

On the report "Environmental taxes and equity concerns "

1. We **welcome the report** as a timely and useful contribution to the debate. I will report back about the main messages of the report and this panel discussion.

2. The report is **illustrative for some broader trends** in policy analysis and debate, namely:
 - a. renewed attention for distributional aspects, also those going beyond simple income measures;
 - b. more stress on the interconnectedness of main policy fields, all too often usually debated and analysed in isolation;
 - c. increased country comparisons, yet with the view of arriving at better tailored policy solutions and not one-size-fits-all solutions.

These trends are also quite visible in the ongoing work within the OECD on the "New Approach to Economic Challenges" which is

based on a widely shared notion that "business-as-usual" policy making has been inadequate in confronting the many challenges facing us today and in the longer term future.

3. I **can agree with many messages** in let-us-say the analytical aspects, such as the following:

a. A tax shift away from labour (and capital) to resource use **can** have a "*double dividend*" of boosting jobs and growth and improving the environment, in this report to reduce carbon emissions. It also depends on the context and policy implementation.

However, less clear from the report, it also depends on behavioural patterns: the increased prosperity can give rise to a "*rebound effect*" undoing partly or wholly the environmental improvement triggered by the better tax incentives.

b. *Price incentives may not be enough* on their own to reduce carbon emissions in an efficient and effective manner. The environmental taxes can help to tackle the main market failure, namely that the carbon pollution is not properly priced. However, as rightly noted in the report, there may also be market failures (and government failures) as regards the development and use of abatement technologies.

I commend the report to forcefully make this point and to relate it to the distributional issues. After all, lower income and vulnerable households may not have the means to invest in energy saving measures.

- c. On a related point, I agree *that merely lowering the price for households subjected to fuel poverty is "a false gift"* and that one should aim at reducing the energy bill in a durable manner, though increasing these households' capacity to deal with permanently higher energy prices.

4. **A few comments on the tax-related issues** where I would like to call for more nuance:

- a. *The "regressive" effect of the tax shift* away from labour to carbon and / or to other resource uses with environmental issues does not only arise from the fact that the environmental tax is regressive but also because the income tax is progressive. A lower reliance on a progressive tax implies a regressive effect.
- b. We should keep in mind that *not all energy taxes are regressive*; it concerns the taxes on heating fuels and electricity. In contrast, the taxes on transport fuels and on vehicles tend to be progressive, as car ownership and use increases with income.

c. We should also recognise *the limited possibilities of the size of the tax shift from labour to carbon* due to the stark difference in the size of the tax bases. Hence, for a substantial labour tax reduction it is simply not possible to only rely on environmental taxation, but other consumption taxes would need to be applied as well. Or, alternatively, one can propose to reduce government spending in the policy package.

However, one can also see this as an additional argument to focus the labour tax reform on certain labour groups, e.g. low income earners, the young, et cetera, also but certainly not exclusively because of the distributional aspects of the increases carbon or environmental tax.

d. The report favours targeted income support over of energy price reductions as a policy tool, and I agree with that.

Yet, I would like to give another key argument for that: a rate differentiation in consumption and environmental taxes tend to affect much wider groups than the vulnerable households one would like to support. Hence it blunts the effectiveness of the tax. This problem tends to grow over time due to political pressures for more or wider exemptions.

5. While **carbon tax** appears a simple and effective tool to address carbon emissions, one **should be mindful of the underlying complexities**:

a. The biggest complication is that the carbon tax figures in the *current context of an Emission Trading System (ETS) in the EU*.

b. It would go too far to invoke the full debate of the merits of tradable carbon permits over a carbon tax.

Briefly: With the former, one is assured of the carbon reduction, but not the carbon price. The latter sets a clear price by the tax rate but one does not know the carbon emissions to be achieved. Carbon trading has the big advantage that it induces technology changes where it is most effective. Both the trading and the tax have stability issues for the longer term: the current carbon price seems too low for deep investment with a very long-term; carbon taxes can change for non-carbon reasons.

c. What I would like to *stress here today is the EU dimension*: national carbon taxes, also informed by national distributional concerns, *risk fragmenting the EU's Internal Market* and *hence threaten to undermine the incentive potential as intended by the ETS*.

d. Just to illustrate the problems in perhaps a too crude way: one should take into account the twin issues of, on the one

hand, delocalisation within and to outside of the EU and the related issue of FDI diversion; and, on the other hand, the consumption issue of imports with a high carbon content.

6. Finally, allow me to make **a few observations on the European Semester** as a means to pursue concrete policy improvements, such as for example insisting on national energy poverty definitions with an income and geographic dimension:

a. The European Semester should be seen as a *political process* in the context of the Europa 2020 strategy. Hence, it predates the six-pack, two-pack and MIP and so on. In essence, it is a *peer review* by Member States on their national policies, concentrated in the issues and in time and it takes the already agreed broad objectives of the Europa 2020 strategy as the base and starting point.

Remember that the CSR packages are adopted through Council Decisions; hence they cannot be seen as the Commission putting pressure on Member states to carry out reform.

b. The review of national policies by other EU countries is *sensitive from a subsidiarity perspective*. In the previous Semesters, Member States have tended to be protective of the policy areas where the EU treaties give the Community level relatively little competence, such as on taxation and

social security. In addition, they prefer to have a CSR indicate the policy problem and a desired policy outcome but leave it to the national government at hand to choose the appropriate policy response.

- c. ***This particular setting may not always be conducive for across-the-board CSRs*** such as perhaps the example of the energy poverty definition. In case there is indeed an EU wide issue, one could wonder whether one should not pursue a Recommendation or Directive to establish a Community framework for national policy. This would give more time for debate and stakeholder involvement than the setting of the European Semester can ever provide.
- d. Yet, there are from various sides ***calls for wider consultation of the CSR content and for more obligations***, perhaps in the form of "contractual arrangements." As regards the first, I would like to recall that Member States have asked for more discussion during the drafting stage which – I need to stress once more – is quite short. An extension of the consultation process with more discussion partners could undermine the Semester's essential character of a peer review across Member States.
- e. As regards ***the prospect of a stronger enforcement of CSRs***, say "increased compulsion", a Member State may be less inclined to accept "strong CSRs" on other Member States with a view of avoiding getting similar constraints

put on themselves. And there is a practical downside as well: any kind of sanction needs a clear trigger and hence would require very precise language. The CSRs would get very detailed, perhaps even legal. In view of the many issues assembled in the process, this would *risk overburdening the whole Semester and in particular that one loses sight on the overall perspective* on a country's structural reforms intended.

- f. *Hence, one should expect that persuasion and best practice would remain the major driving forces in the CSR formulation and follow-up and that compulsion would remain a means of last resort.* Seen from the perspective of persuasion and sharing of best practice, the report's recommendations are a useful contribution to the ongoing debate on the European Semester.

Paul Arnoldus – ECFIN.B4 – tel. 67280