European
Environmental
Bureau

# Environmental Fiscal Reform

## Making Prices Work for the Environment

Campaign Newsletter 2

May 2002

Welcome to the second bi-monthly campaign newsletter of the EEB European campaign on Environmental Fiscal Reform (EFR)!

## EDITORIAL

At a time when the electorate is sending worrying signals of frustration to politicians and governments across the EU, inter-governmental bargaining politics is becoming the norm for negotiations in Brussels. The "I'll give you this if you give me that," or "I'll back you up on this if you back me up on that," behind closed doors is becoming the norm. Bargaining politics have always existed (and always will), particularly in Brussels, but they are taking unprecedented importance in European decision-making, just when people show their frustration with both hypocrisy and the lack of representation they feel at national or European levels. Governments are obsessed with protecting their self-interest in Brussels. But is it in their interest to see their electorate slowly but surely growing distrustful of Europe? This lack of trust will eventually backlash onto national governments (and has already done so). Governments should stop using Brussels as a scapegoat for what they fail to achieve at home. It is time they explain clearly and honestly the European commitment to their electorate, and accept to do their bit for filling up the democratic gap in the Union, a gap that is feeding extremism across the Continent.

The Barcelona Council was typical of the increasing importance of bargaining politics. "I can make an effort in the field of energy taxation if you promise to make one in the liberalisation of energy markets". As a result, the Spanish made this unexpected U-turn just before their Presidency on the Energy Taxation directive proposal, going from years of stubborn opposition to taking up the negotiations with seemingly good will. Environmental NGOs, although surprised, welcomed this move. Then it became clear there was a lot of bargaining behind this.

The Ecofin of May 7$^{th}$, apart from one or two exceptions, warmly welcomed the new compromise text put forward by the Spanish Presidency. No wonder: this new proposal allows for almost all of the tax exemptions you can imagine…. For every sector, there is a derogation possibility. There is now a new special rate for business electricity and gas taxes half of the household rate. But, in turn, there is also a possibility of total exemption for households. And, concerning business, I should write for "low energy use business" as energy intensive sectors can anyway benefit from all sorts of partial or total rebates. Proponents of the text will underline that it offers tax increases of 15-25% on the EU minimum rates for mineral oils, as covered by directives 81 and 82 of 1992. But these rates have not been updated in ten years and most Member States already apply higher rates anyway…Moreover, diesel for the road haulage industry is spared any increase….



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Going back to bargaining politics, we hit a new low when all Member States got together (May 3rd) to protect the three countries that since Autumn 2000, give tax concessions to the road haulage industry in the shape of diesel tax breaks. Although their neighbours protested at the time, they have now rallied to protect France, Italy and the Netherlands, against the "nasty" Commission that watches over the good functioning of the internal market. They came to the rescue of the three culprits certainly against concessions from these Member States in other domains, but also in a demonstration of anger against the Commission.

They all signed the Single European Act, didn't they?

In the meantime, our campaign continues. In this issue of our newsletter, we look at another obstacle against strong Environmental Fiscal Reform (the first one being the lack of EU harmonisation and bargaining politics): the argument that EFR harms competitiveness. And we respond to this argument. Enjoy your reading.

**Campaign Objectives:**

- Implementation of an ambitious and effective Environmental Fiscal Reform throughout Europe.
- Changing consumption and production patterns towards greater sustainability.
- Raising awareness about EFR among the public as well as among governments and private sector players.
- Improving the quality of the political discourse on Environmental Taxation Reform and overcoming resistance.

**Campaign Demands :**

- An additional 10% shift in total tax revenue from labour to environmental use by 2010, at EU and national level
- Removal or reform of all environmentally adverse subsidies by 2005
- Measures to address any potential social impact
- Energy saving and efficiency policies
- Fiscal incentives for environment protection

▸ *see summary of the campaign history, strategy and objectives at http://www.ecotax.info/about.pdf and http://www.ecotax.info/platform.pdf*

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CAMPAIGN NEWS

## European Campaign

### *EU news in brief*

- **Energy Taxation directive proposal**

Although the Barcelona Spring European Summit did not deliver much on sustainable development, it called for the Ecofin council to "reach an agreement on the adoption of the energy tax directive" by December 2002. The Barcelona deal stems from other concessions in terms of liberalisation of the energy market. It remains to be seen what version of the text may eventually be adopted.

After another failure by the Council Taxation Working Party to make any progress in April (this WP meets to negotiate on the technical issues of the directive, such as the tax rates and tax base) the Spanish Presidency took the matter to the COREPER Ambassadors' level, where the political impetus of Barcelona finally came out. The Presidency wrote a new version of their compromise text after this meeting, that it submitted to the Ecofin of May 7th. The Ecofin welcomed this new text and set up a high level Working Group to work further on it. This WG will report to the Ecofin of June 4th, which may take a decision on the text.

However, this compromise text is weak. By trying to accommodate every lobby and Member State, the Presidency will end up with an empty shell. The new compromise text has so many exemptions possibilities and rebates (road haulage diesel, energy intensive industries etc.) that this directive, if adopted in the present form, will cause serious equity problems. The new idea of a business tax rate for electricity and natural gas half of the household rate is ludicrous, especially for such low rates.

(see also editorial)

- **Energy Demand Management**

The Commission is preparing a text (probably a directive) on Energy Demand Management. DG TREN (Transport and Energy) organised a workshop at the beginning of May in order to get the stakeholders' views on the proposal. The main idea, is that, after tackling the energy internal market mainly on the supply side (liberalisation of the electricity and gas markets, Green Paper on the Security of Supply etc.) the EU should complement its energy policy with a policy on the demand side, that would correct some of the effects of liberalisation, notably on the environment.

Energy Demand Management aims at promoting energy efficiency with a market approach. The idea is to stimulate energy companies to sell full energy services including



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energy efficiency equipment and advice, instead of mere energy units. Energy companies would gain more added value from these services than from just the energy product, and energy efficiency would increase on the demand-side. Customers would pay extra for the services, but save on the energy. Nevertheless, this requires a cultural revolution in the business. And one of the challenges of the Commission is the choice of policy instruments for stimulating this development. Indeed, the market of energy services, not profitable enough for the time being, would need incentives to develop.

- **Transport / Diesel taxes**

The Commission (DG Internal Market, Taxation and Customs) is also preparing minimum harmonisation proposals concerning diesel excise duties. The first one aims at reducing the gap between petrol and diesel for non-commercial road fuel duties. This text would have positive impacts for the environment. Indeed, there is no justification for this existing rebate on diesel oil, a fuel that releases more harmful particles in the air than unleaded petrol. Also, lower prices encourage consumption.

The second proposal aims at establishing a harmonised EU rate (within a medium bracket) for diesel used by the commercial transport, in order to create a level playing field within the single market. This proposal can have adverse effects for the environment in countries like the UK where duties are more than twice the EU average. It remains to be seen how such Member States may accept to decrease their rates so drastically.

In the meantime, at the beginning of May, Member States united against the Commission in an unprecedented move to protect the countries (France, Italy and the Netherlands) that introduced diesel tax breaks in Autumn 2000, following world oil price rises. The Commission wanted to sue them for what it deems is illegal state aid. It seems that the unity of Member States took shape against possible concessions in other negotiation areas, and in a demonstration of bad mood against the Commission.
This does not bode well for any solid energy tax harmonisation….

## *The EEB campaign*

- The campaign was officially launched with a Press Conference[1] in Brussels on November 27th 2001. The campaign website was launched in December.

- The EFR Working Group met twice in Brussels to organise the campaign at European and national levels.

- the campaign platform *http://www.ecotax.info/platform.pdf* was published at the end of March. Please contact S. Chevassus (contact below) if you want some paper copies.

1 see press release at: http://www.eeb.org/press/press_release_fiscal_eng_n27.htm

- a round table with unions and social NGOs on EFR was organised at Barcelona as part of a large EEB/ETUC/ European Social Platform conference organised before the European Council, on March 14th. Yannis Paleocrassas, Greek participant to the EEB campaign, former Environment Commissioner and former Finance Minister of Greece, made a presentation explaining how a good design can easily avoid any negative impacts of EFR on income distribution. He also showed the positive relation between EFR and employment.

→ see the joint statement of EEB, ETUC and the European Social Platform for Barcelona "Making the economy work for sustainable development"
http://www.eeb.org/activities/sustainable_development/final-joint-text.pdf

→ EEB Barcelona Conference Report available on the EEB website www.eeb.org

Upcoming main **campaign actions** include:

- participation to the Stakeholders Dialogue of the OECD Environmental Policy Committee (EPOC) on May 22nd in Paris. The main topic will be Environmental Taxes.
- increase of the dialogue with industry.
- participation to the EFR Conference co-organised by the OECD and the German Environment Ministry, Berlin , June 27th. The EEB has been invited as an official speaker.
- follow up of EU negotiations on the energy taxation Commission proposal.
- large EEB Conference on Environmental Fiscal Reform, Brussels October 10th
- possible third EFR workshop for the campaign Working Group (date to be decided).
- elaboration of an "EFR and subsidies European overview table."

## National campaigns

At national level, many new actions have been started by our participating members in Austria, the Czech Republic, Finland, Greece, Ireland and Spain. Belgium, Denmark, Germany, Hungary, the Netherlands, Poland, Sweden, and the UK are carrying on with the actions they were already doing before joining the campaign, while adding this new European profile to their campaigns. Here is some national news from our Members.

## *Belgium*

EEB campaign participants are Bond Beter Leefmilieu and Inter-Environnement Wallonie

An NGO Platform was set up for $CO_2$ / energy tax actions, that did lobbying on the EU Belgian Presidency and issued a leaflet on subsidy reform. An NGO Platform has been set up for preparing the Johannesburg Summit. Work topics will include Climate Change.

Environmental fiscal reform is seen by the NGOs as a broad fiscal reform, not only focusing on the introduction of environmental taxes, but also on the green differentiation of existing taxes. Further to that, the introduction of fiscal incentives is important, the removal of environmentally harmful incentives is very important too.

Energy efficiency and energy taxation are main campaign themes (of Inter-Environnement Wallonie and Bond Beter Leefmilieu).

Bond Beter Leefmilieu will also focus in 2002 on:

- Phasing out the deductible expenses for cars for work commuting
- Phasing out the deductible expenses for company cars (promised by the Federal government)
- Keep on lobbying for the introduction of the product-tax on disposable beverage recipients. The introduction of this tax has been postponed several times.
- Ask for a green VAT differentiation: eco-labeled goods, bicycles, A-labeled electric household equipment, lowering VAT for organic restaurants and catering, and for organic textiles, increase VAT on agricultural chemicals (VAT on pesticides at 21 %) and fertilisers, etc.
  (Annex of 6th VAT directive must be amended for VAT differentiation)
- Start up a campaign to promote the introduction of km-charge (and the creation of a common EU framework)

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## *Denmark*

EEB campaign participant: Danish Ecological Council

Denmark has one of the most advanced Environmental Fiscal Reforms in the EU. However, the new government, elected in November 2001, pledged to stop further developments of the Reform.

January 2002: the new government announced important cuts in almost all public funds for the environment. The budget of the Environmental Protection Agency is to go down


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by 60%. EEB campaign participant the Danish Ecological Council, amongst many others, saw its funding stopped!
Further Environmental Fiscal Reform is stopped. Energy and green taxes will thus go down in real terms.
Three already planned offshore windmills parks have been cancelled. The government might, however, push for the EU "Energy Taxation proposal" when it takes the EU Presidency in July, as Denmark still has interest in minimum EU harmonisation.
Also, the government wants to cut labour taxes: they may realise they need EFR to do this.

The Danish Ecological Council included EFR in its sustainable development campaign.
Actions so far:

- Green Budget Reform campaign
- Ecological Council organised an EFR conference in May 2000 and published a book on EFR in Denmark and other EU countries in January 2001.
- Ecological Council aims at diffusing articles in the press for re-establishing the truth about EFR (attacked and distorted by the Liberal and Conservative parties). The Council also wants to intensify communication about EFR to new opposition parties.
- Ecological Council published leaflets about Sustainable Development market based instruments in March 2002

If you want any paper copies, please ask below (or the EEB, who has some too):

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*More information on all national campaigns is available at* http://www.ecotax.info/

IN-DEPTH TOPIC:
THE IMPACT OF EFR ON INDUSTRY COMPETITIVENESS

## Introduction

One of the main arguments of industry against Environmental Fiscal Reform is the loss of international competitiveness because of higher domestic energy prices. Politicians are very sensitive to the industry's lobbies and to their argument for preserving economic performance and job creation against any new regulation or taxation. As a result, and in the light of the lack of minimum harmonisation of energy taxes at EU level, European countries that have started implementing EFR granted important tax rebates or refunds to energy intensive industries. These rebates (or sometimes total exemptions) cause a


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problem of equity with other socio-economic sectors affected by the taxes (such as households), and considerably weaken the scope of EFR in its primary objective, environmental protection.

Business is generally vehement against EFR, many times without considering carefully all its effects. In "EFR", there is not just "Fiscal" (with the implication of more environmental taxes), there is also "Reform" (and, of course, "Environmental").

## 1. Industry's arguments

Business says that additional energy taxes will seriously damage the competitiveness of those energy intensive sectors exposed to high international competition, such as steel, cement, chemistry etc. For instance, the British Engineering Employers Federation believes the Climate Change Levy will cost industry an extra 160bn euros in the first year.

EFR aims at increasing the price of energy to push users to save and to invest in energy efficient technologies. Industry says that the extra cost of both energy bills and new investment will push up their prices and affect their exports, leading to declining production and job losses.

The OECD writes[1]: "Where the competitiveness of a firm refers in a strict sense to its ability to produce a given level of output (…) at a competitively low output price, it can be said that the energy/carbon tax in certain cases reduces the competitiveness of domestic firms."

Industry brandishes the "delocalisation threat", claiming that new energy / carbon taxes will just push industry to relocate in less environmentally friendly countries and « pollution heavens ». Let alone delocalisation, the OECD points out the possible danger that higher output prices may favour cheaper imports, thus shifting the source of pollution to other countries.

Regions that concentrate energy intensive industries may also be more affected by the new energy taxes than others. These regions have often already suffered from de-industrialisation and job losses.

## 2. Responses to the "competitiveness argument"

Some of the effects of EFR on particular sectors must be taken into account. However, the stubborn opposition of industrial lobbies to EFR is sometimes more emotional or ideological than rational. EFR is about reforming the tax system, not about increasing the overall tax burden.

On higher output prices, the OECD writes: "Two points are worth remembering when assessing the impact of an environmentally related tax on a particular sector. First, pure

[1] OECD 2001: *Environmentally related taxes in OECD countries, issues and strategies.*



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"textbook" conditions rarely apply and environmental taxes are one of a number of factors determining a firm's overall competitiveness. Second, output reductions of polluting activities are often a central goal of environmental reform, and opportunities exist for consumers to shift their consumption towards near substitutes of goods and services that can no longer be profitably supplied post-tax reform."

a. Two main contra-arguments

The two main arguments to oppose the competitiveness argument can be:

- **fiscal neutrality**: presenting EFR as "increased taxation" is not true. One of the main ideas behind the concept of EFR is fiscal neutrality. The revenue coming from new energy / carbon taxes is used to decrease other taxes. The whole operation is revenue-neutral. There is no increase of the overall tax load, but a **shift in the tax base**. European countries with the most advanced EFR (Sweden, Denmark, Netherlands, Germany) have respected this principle, which is very important for the public and industry's acceptability of the fiscal reform.

- **double dividend** : another essential concept is the double-dividend. The tax shift favours both the environment (by increasing taxes on natural resources) and employment (because the tax revenue is recycled towards the reduction of labour taxes). **Business directly benefits from cuts in social security contributions.** This is already a source of compensation for industry against higher energy bills. In Germany, after the first phases of EFR, pension contributions decreased (half for employers, half for employees: total social contributions went from 42.3% to 41.5% of wages)[1]. The plan of the next phases is to get under 40%.

It is true that, although business as a whole will not lose out from EFR, the tax shift may produce winners (labour intensive sectors) and losers (energy intensive industry). But many business sectors will actually **gain** from EFR. In services, for instance, a sector that represents over 50% of the EU GDP, a German study[2] foresees an increase in output of 0.27 % and of employment of 1.29% in 2003, compared with the "non-reform" scenario.

b. Mitigation measures

Many **mitigation measures** can be taken by governments to address any potential competitiveness loss for energy intensive industries:

[1] on the 1st January 2002, as in every year since the introduction of ETR in 1999, motor fuel tax rose by euros 0.03 per litre, while electricity tax went up by euros 0.01 per kilowatt hour. As a result, an additional euros 1.94bn will come off employers' social security contributions in 2002.

[2] *The effects of Environmental Fiscal refrom in Germany: a simulation study* (2001) www.gws-os.de or www.ecotax.info/DIWstudy.pdf by the DIW Institute, the University of Osnabrück and the GWS, and the University of Oldenburg



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‣ These include, naturally, tax rebates and refunds. The OECD (while stressing that large tax exemptions are often not justified, increase administrative costs and undermine the environmental purpose of EFR), recommends the consideration of a *dual rate structure* with a lower rate for the sectors more exposed to international competition. However, too large exemptions deprive EFR of its main goal of reducing energy use and pollution, in some of the sectors where precisely big energy savings can be made[1]. Rebates and refunds should therefore be only temporary and limited, with the idea of just easing the transition for firms towards cleaner technology investment. They should be linked to clear commitments from beneficiary firms of voluntary actions to cut greenhouse gases emissions. Tax rates should gradually be brought to the full rate during such a transition period.

‣ A **gradual implementation** of EFR (with early policy announcements) is indeed necessary to allow companies to adapt and invest in new technologies. Policy consistency is important too. All EFR countries adopted this phase-in approach, often with yearly tax increases over a planned period.

‣ sectoral **income neutrality** can be a good tool to alleviate competitiveness loss concerns: the revenue raised from the ecotaxes energy intensive industries pay is recycled back to the sector (for instance, in the shape of decreases of other taxes, or in incentives for investment in cleaner technologies).

‣ **Regional aid policies** can help regions that concentrate energy intensive industries. Fiscal incentives for research and development can assist these industries in investing in cleaner technologies. These measures may actually be easier to take regarding EU state aid legislation than continued energy tax exemptions that seem to bring about more and more wrangles between the Commission and Member States.

‣ Another important mitigation possibility is international, or at least regional, **harmonisation** (the OECD calls it *co-ordinated implementation)*. In a world increasingly open to foreign trade and competition, firms would face similar environmental tax constraints if new energy/ carbon taxes were introduced in a co-ordinated manner, at least, to start with, in OECD countries. In this respect, the EU situation can be read in two ways. A pessimistic reading would underline the difficulties to get any minimum harmonisation, even inside an already rather integrated group of countries. An optimistic reading would highlight the way European countries have immensely influenced each other in the development of EFR, resulting in a world lead in EFR experiments.

There are other contra-arguments against the "competitiveness argument":

- One of them comes from the fact that EFR pushes firms to invest in cleaner technologies in order to save on energy taxes. **Development of R&D increases the**

[1] moreover, these rebates cause a problem of equity with other socio-economic sectors affected by the taxes (such as households, transports, SMEs). And the complexity of these national exemption systems now makes EU harmonisation even more difficult.


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**overall competitiveness of firms in the medium to long term.** R&D pushes innovation that eventually gives a competitive edge to companies. Moreover, the OECD points out that "the R&D undertaken to adapt technologies to avoid the energy/ carbon tax could generate spillover benefits to other producers and sectors".

The potential competitiveness gain can indeed be illustrated by the fact that, inside the EU, countries with higher environmental regulations and taxation have never lost their innovative edge, in term of products, to countries that compete on more lax regulation and lower wages. On the contrary: Denmark, one of the leading countries in terms of EFR and renewable energy[1] development, is today the world's leading producer of wind turbines. A study (C. Ege) estimated that the total employment effect of greening the Danish economy amounts to 28000 new jobs.

In Sweden too, another EFR frontrunner, a survey[2] has recently shown that environmental technology and services could become Sweden's "next major export industry". The investigation, carried out by the Swedish trade council and a network of 500 consultancies and suppliers working in water and waste treatment, waste management and air pollution control, estimates export revenues in 2000 at SKr8bn (euros 847m), or 1% of total national exports.

- By saving on energy consumption, industry in the end will save not only on tax, but also on energy consumption. Total energy bills may therefore go down, in relative terms, in the longer term.

- Cutting on energy consumption and pollution will improve the business image of industry.

- Regarding energy prices, industry should also be reminded that it has always benefited from very advantageous prices. Often stemming from governments' industrial policy when most electricity suppliers were still state-owned, these **low prices** are not justified by mere bulk purchase discounts. They amount to true energy subsidy. Figures indicate that average EU electricity prices were 5.4 US $ cents per kWh for industry in 2000, compared to 12.5 for households[3]. Moreover, the price decrease trend of the nineties is much stronger for industrial prices than for household prices. In the EU, this trend is pushed further by the liberalisation of energy markets.
  Also, energy prices have fallen in real terms since the 50's and do not reflect the scarcity of fossil fuels in the short to medium term.

- It must never be forgotten that the primary aim of EFR is to move towards a better internalisation of environmental external costs: therefore the savings[4] thanks to **external costs reductions** must be taken into account too. In the end, even the industry will benefit from a better quality of life, the reduction of external costs and a more sustainable development.

[1] renewable energies are exempted from new EFR energy taxes
[2] See Swedish environmental technology network www.swedentech.swedishtrade.se
[3] IEA 2001
[4] the amplitude of which naturally depends on the scope of EFR, but it could be in « billions »



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- EFR can be the opportunity for a large **reform of the fiscal system**, making it more modern and more efficient. In Sweden, Denmark, the Netherlands, and Germany, governments have implemented EFR within an overhaul of the taxation system. The fiscal system usually comes out of these reforms more business-friendly. Countries that suffer from high tax evasion may take advantage of EFR to increase indirect taxation, which is more difficult to evade, and decrease direct taxation.

## Conclusion

Politicians and governments should not get intimidated by the loud voice of the strong and well-established lobbies of heavy industry. The latter know very well how to influence politicians with the « competitiveness », and therefore the « job argument ». Yet other essential economic sectors, such as SMEs and services know little about EFR and how they can benefit from it. The « competitiveness argument » is exaggerated. Most business sectors will benefit from EFR, from the tax shift from labour to natural resources and from the fiscal reform.

Should some energy intensive industries be really affected by the new energy taxes, some mitigation measures can apply. But this should not be a reason to generalise large rebates and exemptions to sectors where, precisely, a lot of energy saving can and must occur.

***Don't hesitate to react to the content of this newsletter***

‣ Do you believe Environmental Fiscal Reform can harm industry competitiveness, considering that energy prices will have to increase in the medium term because of the inevitable depletion of fossil fuel reserves?
And considering that countries with the most advanced EFRs (Sweden, Denmark, Netherlands, Germany) are not precisely the least competitive?
‣ What is your view of the Member States attitude with the Commission on diesel tax breaks? Will we ever see a level playing field, a real internal market, for the road haulage industry?
‣ In your opinion, can we expect anything from the Energy Taxation directive proposal? Is it better to have low new EU minimum rates (electricity, natural gas) than nothing?

***erratum***: in the first campaign Newsletter dated March 2002, we omitted the full references of the contributors to the study: *The effects of Environmental Fiscal refrom in Germany: a simulation study* (2001). These are: the DIW Institute, the University of Osnabrück and the GWS, and the University of Oldenburg

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### *The European Environmental Bureau (EEB)*

*The EEB is a federation of 133 environmental citizens organisations based in all EU Member States and most Accession Countries, as well as a few neighbouring countries. They range from local and national to European and international. The aim of the EEB is to protect and improve the environment of Europe and to enable the citizens of Europe to play their part in achieving that goal The EEB office in Brussels was established in 1974 to provide as a focal point for its members to monitor and respond to the emerging EU environmental policy. It has an information service, it runs nine working groups of EEB-members, it produces position papers on topics that are, or should be, on the EU agenda and it represents the Membership in discussions with the Commission, European Parliament and the Council. It closely co-ordinates EU-oriented activities with its Members on the National levels. Furthermore it follows closely the EU enlargement process as well as some pan-european issues like the follow up of the Aarhus Convention.*

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