

## Why Ecotaxes May Not Be the Answer

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*No serious assault on climate change can ignore the role of tax. But, as **Nicola Liebert** reports, the experience of Germany reveals some familiar political weaknesses.*

Imagine a tax that fights environmental pollution and unemployment at the same time. A real win-win tax, in other words, that causes hardly any pain because the money is returned to the taxpayers. Too good to be true? Not so, thought Hans Christoph Binswanger, an economics professor at the renowned Swiss university of St Gallen. Some 25 years ago he developed the idea of an ecological tax reform that is revenue-neutral but would still have the effect of steering the economy away from an energy-intensive and therefore unsustainable path.

The idea is simple enough: levy a tax on energy and use the proceeds to slash social security contributions. 'Labour must be made cheaper without lowering wages,' Binswanger demanded in an interview with the German paper *Die Tageszeitung*. A tax set up in such a way solves several problems at once, he said.

First, it encourages the creation of jobs. Lower payroll fringe costs make it cheaper for companies to hire more staff than to invest in labour-saving but energy-guzzling new machines.

Second, individual households are rewarded for saving energy. The less they use at home or on the road, the lower their tax payments. They might even get more back via the social security rebate than they pay in taxes. A kind of redistribution takes place from energy spendthrifts to the thrifty.

Third, while consumption taxes generally raise issues of equity – because they tend to burden low-income households more than the top earners – this is less true of Binswanger's tax. In countries like Germany, low- to middle-income households pay disproportionately more into the social security system than the wealthy, and would benefit more from a lower rate of contribution.

### **Outrage**

It was an idea whose time had come when, 10 years ago, the Green Party went into government in Germany as the junior partner of the Social Democratic Party. Within a year, Parliament had passed a Binswanger-style ecological tax reform. The 'ecotax' was raised in increments to €0.15 (\$0.23) per litre on top of normal fuel taxes, and €20.50 (\$32) per megawatt hour of electricity. The receipts went for the most part into the state pension fund.

The corporate world reacted with outrage. The supposed cost neutrality of the reform, they argued, might be fine on a 'macroeconomic' scale, but not for individual companies. Utilities, steel plant or cement factories would have to pay a lot more taxes than, say, banks or software companies, even when the lowered labour costs were taken into account. And then what would happen to the famed competitiveness of German industry?

The result, as so often in politics, was a compromise between ecological desirability and economic demands. Industrial companies pay only 60 per cent of the standard ecotax rate on electricity, and zero per cent on fuel. Companies with especially high energy use that save less in social security than they have to pay in green taxes can get a partial refund. The most energy-intensive industries, where more energy efficiency would make the biggest difference, thus have the smallest incentive to achieve it.

Has the ecotax paid off, in spite of its shortcomings? 'More jobs, less environmental pollution,' boasts the Environment Ministry on its website. But it made no dent, for instance, in the pattern of rising petrol consumption. Its defenders argue that without it the increases might have been even faster, in line with the growing number of cars. At any rate, the Deutsches Institut für Wirtschaftsforschung, a research institute based in Berlin, calculated that the green tax was responsible for a decline in carbon emissions of 2.4 per cent between 1999 and 2003.

On the labour market side, though, the return has been nil. The downside of the many exemptions is that the tax receipts only allowed for a cut in social security contributions of 1.7 per cent – hardly visible to the naked eye, given that in Germany those contributions take up almost 40 per cent of gross wages. Tax experts are now debating whether investing the monies in better public transport might be a much better idea.

## **Shangri-la**

How about other countries? Denmark, in particular, which introduced a carbon tax for private households in 1993 and for businesses in 1995, has often been praised as the green tax Shangri-la. The green tax revenues are used to lower notoriously high Danish income taxes, while companies get a refund on their labour market contributions.

Here, too, industry was able to secure certain privileges, but unlike in Germany they came with strings attached: businesses can only be exempt from the green tax provided they commit to an emissions reduction plan. An evaluation by the Danish Finance Ministry from 1999 put the reduction in carbon emissions as a consequence of the ecotax reform at four per cent in ten years. Sweden, Finland and the Netherlands offer further examples of successful green tax reforms, all introduced in the last decade.

Even the European Union, which in 1994 abandoned all attempts to introduce an EU-wide green tax, is slowly warming to the idea again. In March 2007 the EU Commission published a Green Book, in which it called for 'market-based instruments' to make polluters pay for the remedy of environmental pollution.

The new buzzword is carbon taxes. They might just be the perfect tool to meet the reduction targets to which the signatories of the Kyoto Protocol on Climate Change committed. The German Government decided this summer to revamp its motor vehicle tax so that in future the rate depends on the amount of carbon emitted from exhausts. France, in particular, has repeatedly come out in support of carbon taxes; this is not so surprising, as that country gets most of its electricity from nuclear power and would be hardly affected by such a tax.

### **Few and far between**

Examples of comprehensive carbon taxes remain few and far between. After New Zealand/Aotearoa scrapped its ambitious carbon tax plan in 2005, the trendsetter now is the Canadian province of British Columbia. In July 2008 a carbon tax entered into effect that is set to rise from \$10 to \$30 per tonne of CO<sub>2</sub> by 2012. The money comes back to taxpayers via an income tax cut. To offset the effects of the higher fuel costs on lower-income households, they will receive an additional annual payment of \$100 per adult and \$30 per child.

British Columbia may remain an exception. The Canadian press reports that the Government was already feeling the heat over the new tax even before it was introduced, as the price of petrol reached new highs almost every day, making energy or emissions taxes a particularly hard sell. Truck drivers across England and later in France, Spain and Portugal blocked roads this year, demanding an abatement of fuel taxes.

If developed countries find it difficult to impose new green taxes – or even to sustain existing ones – it appears all but impossible in the developing world. They worry that their attempt to catch up with the developed countries will stall without cheap power and labour. After all, didn't the North develop its industry based on the availability of cheap coal and oil?

At last year's World Economic Forum in the Swiss resort of Davos the former World Bank chief economist, Nicholas Stern, nevertheless spoke out in favour of a global carbon tax. The author of the report, commissioned by the British Government, on the economic effects of climate change said that ruling out carbon taxes was 'a risk we cannot take'. But he added that the industrialized countries, which have caused most of the problem, should contribute more to its solution.

This sounds good, but Stern only hints at the two crucial issues. First, how can the industrialized countries be made to contribute more to the solution of the greenhouse problem? Probably not through higher carbon taxes, as governments find it difficult in times of soaring oil prices to defend even existing fuel taxes. And can we expect developing and emerging economies to levy even small taxes on energy consumption? Probably not: major carbon emitters like China and India have only recently – at the G8 summit in Japan – rebuffed all suggestions that they commit to a reduction in their carbon emissions.

Green taxes were a brilliant idea when they were first conceived. But, in the quarter-century since then, globalization – and the growing awareness that environmental issues are global, too – has changed the world. Properly implemented, green taxes still may be a useful steering tool for some countries such as Germany or Denmark. But for a solution of global problems, which requires careful balancing between worldwide environmental necessities and the economic needs of the developing world, we may have to look elsewhere.