GREEN
EUROPEAN
JOURNAL

What if Fiscal Policy Was Driven by Climate and Social Justice?

Article by Seden Anlar
June 21, 2023

The climate movement’s call for “polluter pays” and “tax the rich” have gained traction in recent years, with the UN Secretary-General Antonio Guterres joining the chorus in a biting speech on fossil fuel companies and their enablers. However, the policy outcome of these demands has been less than impressive. Journalist Seden Anlar examines the harmful fiscal policies implemented thus far in the EU and the tax justice approach the EU must adopt to protect people and planet.

Staggering inflation, looming energy bills, increasing rental prices – we are in the grips of theworst cost-of-living crisis in decades. The numbers are telling. Recent research by Oxfam shows that the wages of 1.7 billion workers are outpaced by inflation and over 820 million people worldwide are now facing hunger. The situation in Europe reflects the global picture. Today, at least50 million Europeans live in energy poverty, food banks are overwhelmed with new applicants, thousands face job losses as a result of the energy crisis, and many more are losing their homes due to skyrocketing rents.

The impact of this economic downturn is so widespread that, according to the latestEurobarometer survey, 93 per cent of poll participants are worried about thecost of living crisis while 45 per cent of respondents are currently having “some” or “a lot” of difficulties with their personal income. The rising cost of living is taking its toll, especially on young people and their living standards as they suffer yet another blow following the pandemic. The OECD recently warned that young people were being disproportionately hit by the crisis and that there was a risk of “long-term scarring” on their careers and economic outcomes.

However, not everyone seems to be losing out. Fossil fuel companies had a field year, announcing record-breaking profits through hundreds of billions in subsidies and windfall profits. In 2022, Shell Energy posted quarterly profits of 13 billion euros, a 92 per cent increase compared to the previous year, while France’s Total SE saw its quarterly income triple to 9 billion euros. These profits went to the hands of the company shareholders with higher dividends, while household budgets shrunk, the energy transition stalled, and the climate crisis worsened.

As inflation rose, more and more people started going through economic hardship, and this stark contrast became more visible, all eyes turned to the EU for answers and solutions. Although the EU has taken some positive steps like windfall taxes, such quick fixes will not suffice to address and solve the interconnected issues we are currently facing. For this, Europe’s fiscal system needs to go through a transformation from one based on a linear economic model to a circular one that is equipped to address the inequalities that have been exposed and magnified by the cost of living crisis, transition out of fossil fuels and tackle the climate crisis, and ultimately make the EU more resilient to future crises. Addressing Europe’s economic, environmental, and social challenges not only calls for reforms but also a clean break from austerity, giving governments further spending capacity to invest in effective public services. But where do we get the money?

Economists are often asked: what if governments just printed more money? Theproblem with this approach is that it would only increase the amount of currency in circulation without regulating economic activity. In essence, if consumers can buy more things with printed money, businesses are incentivised to keep their production levels and increase their prices instead – effectively fuelling inflation. As Europeans grapple with the cost of living crisis, spurring inflation is a risk they cannot afford.

Follow the money

Instead of printing more money, what if governments followed the money, rebalanced Europe's tax mix, and put climate and social justice at the heart of their revenue-raising activities? Tax justice is an important piece of this fiscal puzzle that can help the EU tackle the cost of living crisis and the climate crisis by curbing inequalities, funding effective public services, promoting sustainability, and eliminating socially and economically destructive behaviour by companies. Through taxation, governments can send signals to set incentives in accordance with their goals and priorities to drive permanent changes in behaviour and investment. Yet, taxes as a means to achieve these have been massively underutilised in the EU as tax policies have been shaped to protect the interest of the most powerful individuals, multinationals, and polluters for the sake of competition and GDP growth.

According to the Ex'tax Project Foundation, since 2021, the EU Member States collect over 6 trillion euros in taxes every year. The majority (51.7 per cent) of this amount comes from labour, personal income tax, payroll taxes, and social security contributions while only 5.9 per cent of the tax revenue is generated from environmental taxes. These taxes cover all uses of natural resources, including fuels, metals, minerals, water, air, and soil, in addition to pollution and emissions of CO2 and other greenhouse gases.

While the EU deploys two significant carbon pricing mechanisms, the Emissions Trading System (ETS), which is a market-based instrument that allows companies to buy and sell emission allowances and carbon taxes which are levied directly on the amount of greenhouse gas emissions produced by a company or industry, according to the European Court of Auditors, the level of taxation of energy sources in the EU does not reflect the greenhouse gas emissions. Many harmful activities remain tax-free, including the burning of kerosene and bunker fuels in ships, air pollution from factories to power aircraft and harmful substances leaking into the air, water and soil from agricultural practices.

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Research shows that in the EU, energy consumption results in 340 billion euros in external costs, such as the impacts of emissions from power plants on health, ecosystems, agriculture, buildings and the climate. Only 10 per cent of these costs are passed on to producers through the ETS and carbon tax policies. In other words, the polluters in the EU do not pay their fair share.

This unequal tax burden has persisted for decades. The EU and its member states have, for too long, shied away from fair, green and social tax policies, protecting the interest of the most powerful individuals, multinationals and big polluters instead. Even though "the polluter should pay" principle is etched into the founding Treaties of the EU and is widely promoted by EU institutions, the environmental tax share of all public revenues barely changed between 2006 and 2013 and has generally been falling since the mid-1990s.

Polluters don't pay, they get paid

Not only have polluters escaped fair taxation, but they also get paid. From the conclusion of the Paris Climate Agreement in 2015 to 2019, G20 countries have spent 3 trillion euros on fossil fuel subsidies. In Europe alone, Climate Action Network (CAN) reports that EU member states provided 55 to 58 billion euros of explicit subsidies for fossil fuels each year between 2008 and 2019.

As if these amounts were not enough, over the past few years, fossil fuel subsidies have been increasing, especially since 2021 as a response to the Covid-19 pandemic and to the war in Ukraine. In 2022, governments around the globe spent more than 900 billion euros on subsidies, which is more than double the 2021 total and the highest figure ever recorded.

These subsidies make the production and consumption of fossil fuels cheaper, which ultimately increases CO_2 emissions and undermines climate goals. They also make the transition to renewable energy harder as 15 member states allocate more subsidies to fossil fuels than to renewables.

Who pays for these subsidies, one might ask? It is me and you. 70 per cent of the subsidies are provided through tax expenditures. While a common misconception around subsidies is that they support poor households and ensure access to energy for those that do not have it, in practice, they generally benefit the richest households more as they consume proportionally more energy and therefore receive a larger share of the benefits from subsidies.

Workers, who?

Such a tax mix and incentives that reward environmentally destructive production and consumption patterns are manifestations of the take-make-waste economic model, which maximises resource extraction and consumption while minimising human capital input.

The EU's taxation system's over-reliance on labour – the most distortive type of tax – not only has an impact on the climate but also on the labour market since it incentivises employers to cut back on jobs to generate revenue. As unemployment remains a huge challenge in Europe with over 13 million people struggling to find work and employers suffer from staff shortages, this tax mix is not aligned with the needs of the labour markets.

The remedy is simple. As the UN Secretary-General António Guterres puts it: "Tax pollution, not people." This can be done through a taxshift that will lower the tax burden on labour and compensate for it by increasing or introducing taxes on pollution and resource use. Such a taxshift would reduce the tax burden on labour and working people, enable job creation, increase social spending, and strengthen environmental protection.

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Environmental taxes not only encourage businesses to reduce emissions and energy consumption which can lead to investments in more efficient technologies and processes, but also fund climate action and mitigation efforts. For instance, under the European Green Deal, a portion of the revenue generated by the ETS is earmarked for investments in clean energy, climate adaptation, and other measures to help reduce greenhouse gas emissions and climate mitigation.

The taxshift is becoming increasingly popular around Europe with several governments introducing policies that go in this direction. Belgium, the third-highest taxed country in the EU, is debating a major tax reform in its federal government that would reduce labour taxes and compensate it with increased taxation on consumption and pollution. The bill could take effect in January 2024 if approved.

Easier said than done

The taxshift might sound simple on paper, but in practice, it is challenging to introduce and implement it. While the European Commission has been trying to shift the tax burden away from labour to pollution and resource use for the past 30 years, not much progress has been made and things are not moving fast enough.

The main reason is that EU taxation is in principle a matter of national competence, and each member state's tax mix is shaped around competition within the EU. When a member state seeks to make big polluters pay their fair share, large multinational corporations can simply move to another member state and flee their obligations, which creates pressure on the government. This harmful competition combined with the unanimity requirement for EU decisions and amendments on taxation-related matters has locked the EU into a tax mix that is not fit for purpose.

As EU member states face several shared challenges, the answer lies insolidarity and moving from tax competition to tax cooperation. Collaboration should not only take place between governments but also amongst different parts of the EU institutions that implement strategies. This is necessary to find a comprehensive approach as the taxshift measures cut through many EU policy areas, programmes, and action plans including the Green Deal, the Fit for 55 package, the Zero Pollution Action Plan, the Farm to Fork strategy, the Waste Framework Directive, and the European Pillar of Social Rights Action Plan.

Even if these barriers were to be overcome, there still needs to be strong political will behind the taxshift. Yet, for many politicians, this is a hard sell; introducing new environmental taxes that include polluting activities and resource use ignites fears of competitive disadvantages and such a tax policy reform creates conflict between governments, industries, and lobbies that have a strong interest in maintaining the status quo.

One of the most-cited arguments against environmental taxes is that they willdisappear over time. Indeed, the nature of this tax base means that a decarbonised economy will inevitably lead to the erosion of some of the revenues generated from environmental taxes. However, this should not preclude introducing taxes on pollution and resource use as the erosion ultimately means that these taxes accomplish their main goal: to help reach the EU climate goals.

In general, governments have several tools at their disposal when taxes erode such as increasing the tax rates or broadening the tax base to compensate for the decreasing revenues. But the approach taken to tackle the erosion should go beyond simple and quick fixes and should be seen as the next evolutionary step in a dynamic taxation system that is rebalanced and adjusted continuously according to changing circumstances and challenges.

The way forward

If the EU is serious about its goal to become the first carbon-neutral continent by 2050, it needs to follow through with the commitments in the European Green Deal which include a taxshift from labour to environmental taxes and rebalance its tax mix in line with a just transition that is also social. Only a well-designed and implemented taxshift can address the interconnected challenges the EU is currently facing, provide financing for the investments necessary for the ecological and social transition, and ultimately make the EU more resilient to further shocks.

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Published June 21, 2023
Article in English
Published in the *Green European Journal*